



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

NO PROTEST RECEIVED
Release to Manager, EO Determinations - C

DATE: [REDACTED]

SURNAME [REDACTED]

DOO

Date:

JAN 17 2000

Contact Person: [REDACTED]

Identification Number: [REDACTED]

Contact Number: [REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(9). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were formed on [REDACTED] pursuant to a Trust Agreement made and entered into between [REDACTED] a [REDACTED] corporation, and [REDACTED] as Trustee. Under Recitals, the Agreement states that [REDACTED] (the "Employer"), has established a [REDACTED] (the "Plan") for the administration and distribution of contributions made by it for the purpose of providing welfare benefits to eligible employees. All such benefits are intended to comply with the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), as amended, applicable to employee welfare benefit plans, and all applicable provisions of the Internal Revenue Code of 1986, as amended. Further, the Employer intends that the Trust, when taken together with the Plan, shall constitute a "voluntary employee benefit association" within the meaning of section 501(c)(9) of the Code.

Article II, Sec. 2.6 of the Trust Agreement sets forth the Trustee's powers relating to distributions to be made from the Trust Fund, including the following: "(b) Upon full termination of the Plan to distribute at the direction of the Plan Administrator pursuant to Section 8.5 of the Plan, to each Participant any insurance policy on the Participant's life held by the Plan as of the date of termination together with the Participant's *pro rata* share of any other Plan assets based on the Considered Compensation of all Participants for the Plan Year immediately prior to the Plan Year in which the termination occurs."

Article III, Sec. 3.1 of the Trust Agreement states that the Plan Administrator shall be charged with the general administration of the Plan. This includes the exclusive responsibility for determining the costs of the welfare benefits provided under the Plan and the method by which such costs shall be funded. Further, "the Plan Administrator shall have the exclusive

[REDACTED]

authority to direct the Trustee with respect to (i) all disbursements from the Trust Fund and (ii) the investment of such portion of the Trust Fund as it shall specify in writing to the Trustee."

Article VIII, Sec. 8.3, provides, in part, that, "The Employer may terminate this Trust Agreement by executing and delivering to the Administrator and the Trustee a notice of termination which specifies the date on which the Trust Agreement shall terminate. ...Remaining assets of the Trust Fund shall be applied by the Trustee, as directed by the Administrator, pursuant to Section 8.5 of the Plan."

Article IX, Sec. 9.4 provides, in part, that, "In no event shall the principal or income of the Trust Fund be paid to or revert to the Employer or be used for any purpose other than the exclusive benefit of the Participants or Beneficiaries and the reasonable expenses of administering the Plan and Trust. However, if the Commissioner of Internal Revenue... determines the Trust... is not a qualified Voluntary Employees' Beneficiary Association described in Code Section 501(c)(9) exempt from Federal income tax, then... the Trustee, upon written notice from the Employer, will return the Employer's contributions... to the Employer."

The Welfare Benefit Plan states that [REDACTED] establishes this Plan with [REDACTED], as Plan Administrator. The Plan is executed concurrent with the Trust Agreement.

Article I of the Plan, entitled Definitions, defines, in Sec. 1.1, the term "Active Employee" to mean the period or periods of active employment with the Employer, during which period or periods an Employee shall be credited with one year of Active Service for each Plan Year during which the employee is entitled to be credited with 1,000 or more hours of employment. Sec. 1.3 defines the term "Break in Service" to mean a one-year break in Active Service occurring only if the Employee has not completed more than 500 hours of employment during the Plan Year. In such instance, years of Active Service prior to the break shall not again be taken into account for any reason.

Sec. 1.5 defines the term "Considered Compensation" to mean, as to each participant, the total of all compensation from the Employer, including wages, salary, and any other benefit of monetary value includable in the Participant's gross income for federal income tax purposes for the Plan Year immediately preceding the Plan Year in which the Participant's death occurs, which was paid as consideration in connection with the Participant's services, including amounts which are contributed by the Employer pursuant to a salary reduction agreement and which are not included in the gross income of the Participant under Code sections 125, 402(a)(8), 402(h), 403(b), or 401(k).

Article II, Sec. 2.1 posits the Eligibility Requirements as follows: any Employee shall be eligible to participate in the Plan immediately following the later of the date the Employee completes two (2) years of Active Service and attains age twenty-one (21). Also, Employees who are included in a unit of Employees covered by a collective bargaining agreement between the Employees' representative and the Employer shall be excluded if benefits of the type provided by the Plan were the subject of good faith bargaining between the Employees'

representative and the Employer and the Agreement does not require the Employer to include such Employees in this Plan.

Article III, Sec. 3.1, entitled Death Benefit, provides that if a Participant dies while in the active employ of the Employer, the Participant's Beneficiary shall be entitled to receive a death benefit equal to the lesser of the amount of insurance in force insuring the life of the Participant at the date of death or the Plan Multiple multiplied by the Participant's Considered Compensation. The Plan Multiple shall be 12.5. However, Sec. 3.2 provides that the minimum benefit provided by the Plan shall be \$50,000 notwithstanding the calculation from Sec. 3.1.

Article IV, Sec. 4.1, provides, in part, that the Employer shall contribute and pay over to the Trustee, to be held and administered in the Trust Fund, the amounts necessary to cover the qualified cost of the benefits to be provided by the Plan. The minimum contribution prescribed by the actuary shall assume such interest, mortality, turnover, and other rates as the actuary shall from time to time determine to be reasonable. Sec. 4.3 states that no contributions by Participants shall be required.

Article VIII, Sec. 8.1, provides that the Employer shall have the sole right to amend the Plan Document with the consent of the Plan Administrator and the Trustee. Sec. 8.3, entitled Limitations on Right to Amend, provides that no amendment shall: (a) have the effect of vesting in the Employer any interest in the assets of the Trust Fund; or (b) cause or permit any assets of the Trust Fund (other than the part which is required to pay taxes and administrative expenses) to be diverted to any purpose other than the exclusive benefit of the present or future Participants and their Beneficiaries through the provision of benefits of the type specified in Sec. 3.1 of this Plan Document.

Sec. 8.4 states that the Employer may suspend or discontinue its Contributions under the Plan, and to terminate, at any time, this Plan and the Trust created under this Plan. Sec. 8.5 provides that if the Plan is terminated pursuant to Sec. 8.4, the Plan Administrator shall instruct the Trustee to distribute to each Participant any insurance policy on the Participant's life held by the Plan as of the date of termination together with the Participant's *pro rata* share of any other Plan assets based on the Considered Compensation of all Participants for the Plan Year immediately prior to the Plan Year in which the termination occurs. All terms and conditions of such distributions shall be administered on a uniform and nondiscriminatory basis.

Sec. 8.6 provides that, "All Contributions under, and all assets and earnings of, the Trust Fund are solely and irrevocably dedicated to the payment of (i) benefits of the kind and type described in this Plan Document for the benefit of the Participants and their Beneficiaries and (ii) the reasonable expenses of administering the Plan and Trust."

In response to Part II, 1, of Form 1024, exemption application, you state that the Trust is a single employer and welfare trust which provides a "death benefit only" to eligible employees of the employer. All contributions and expenses are paid by the employer.

In a letter dated [REDACTED] from your authorized representative, you have informed us that the Plan has only two Participants - [REDACTED] President/Owner of the

[REDACTED]

sponsoring employer, and his wife, [REDACTED] Secretary. For [REDACTED], you pay out \$[REDACTED] per annum for a life insurance policy with a face amount of \$[REDACTED]. For [REDACTED], you pay out \$[REDACTED] per annum for a policy with a face amount of \$[REDACTED].

A financial statement for your taxable year ending [REDACTED], shows, under "other assets", on line 10, an amount of \$[REDACTED], which, in the letter of [REDACTED], is identified as the cash surrender values of the above life insurance policies. For [REDACTED] policy, the cash surrender value is \$[REDACTED].

Section 501(c)(9) of the Code describes a voluntary employees' beneficiary association ("VEBA") providing for the payment of life, sick, accident or other benefits to its members or their dependents or designated beneficiaries, and in which no part of its net earnings inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-2(a)(ii) of the Income Tax Regulations identifies certain generally permissible restrictions on eligibility for benefits. Under subsection (F) of that section, a VEBA may provide life benefits in amounts that are a uniform percentage of compensation received by the individual whose life is covered.

Section 1.501(c)(9)-3(d) of the regulations provides that the term "other benefits" includes only benefits that are similar to a life, sick, or accident benefit. A benefit is similar to such permissible benefits if (1) it is intended to safeguard or improve the health of a member or a member's dependents; or (2) it protects against a contingency that interrupts or impairs a member's earning power.

Section 1.501(c)(9)-3(f) of the regulations provides examples of nonqualifying benefits. It states that the term "other benefits" does not include any benefit that is similar to a pension or annuity payable at the time of mandatory or voluntary retirement.

Section 1.501(c)(9)-4(a) of the regulations provides that no part of the net earnings of a VEBA may inure to the benefit of any shareholder or individual other than through the payment of permitted types of life, sick, accident, or other benefits. Whether prohibited inurement has occurred is a question to be determined with regard to all the facts and circumstances of a particular case.

The term "net earnings" is given a broad interpretation, subjecting all of the assets of an organization to the inurement prohibition. See, Knollwood Memorial Gardens v. Commissioner, 46 T.C. 764 (1969), appeal dismissed nolle pro. Section 1.501(a)-1(c) of the regulations provides that the "words 'private shareholder or individual' in section 501 refers to persons having a private interest in the activities of the organization." Clearly, an individual related to a VEBA as a member-beneficiary and owner of the contributing employer has a personal interest in the VEBA's activities and is subject to the section 501(c)(9) inurement proscription.

A VEBA functions primarily as a cooperative device for pooling funds and distributing risks over and benefits to a defined group of employees sharing an employment-related common bond. Thus, while an organization may provide permissible benefits to promote the common

[REDACTED]

welfare of an association of employees in a manner consistent with the requirements of section 501(c)(9), the inurement proscription precludes the tax exemption of an organization predominantly operated to promote the interests of an individual or individuals standing in relation to the organization as an investor for private gain. See Rev. Rul. 81-94, 1981-1 C.B. 330, and Church of the Transfiguring Spirit, Inc. v. Commissioner, 76 T.C. 1 (1981).

The business corporation which fully funds the Trust and Plan herein is 100% owned by [REDACTED]. While [REDACTED] does not serve as either the Trustee or Plan Administrator, nevertheless, he is able to exert control over its operations because he controls the purse strings; the VEBA herein is fully dependent upon funding from the corporation which he controls and he can terminate the Trust at any time. See Article VIII, Sec. 8.4 of the Plan Document. Further, [REDACTED] and his wife [REDACTED] are the only beneficiaries of the whole life insurance policies taken out by the Plan. A limited membership in combination with the allocation of all Plan benefits to [REDACTED] the owner of the funding employer, and his wife indicates that you are organized and operated for the benefit of the [REDACTED] and not for any employee group. The Plan accumulates funds solely for the benefit of the [REDACTED]. Furthermore, because the underlying Trust is subject to termination at the discretion of [REDACTED] he is able to direct the distribution of Trust assets to his wife and himself. In this manner, the Trust functions substantially as an investment fund for the direct and private benefit of the owner and his wife. The accumulation of investment funds for the private benefit of the [REDACTED] does not fall within the ambit of permissible benefits as described in section 1.501(c)(9)-3(d) and (e) of the regulations. Under these circumstances, the Trust is organized and operated to promote the private interests of the owner's family and thus violates the inurement proscription under section 1.501(c)(9)-4(a).

In addition, asset distributions to the [REDACTED] upon the Trust's termination would also constitute nonqualifying deferred compensation under section 1.501(c)(9)-3(f) of the regulations. Based on [REDACTED] control over Trust termination, such distributions would be payable by reason of the passage of time and not as a result of an unanticipated event. Further, the fact that termination distributions originate from a Trust organized and operated solely for the benefit of the [REDACTED] indicates that such distributions are similar to those provided under a plan or arrangement of deferred compensation.

Based on the foregoing, we rule that you do not qualify for exemption as an organization described in section 501(c)(9) of the Code. Therefore, you must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

[REDACTED]

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201.

Although not directly relevant to the determination of your exempt status, you should know that the deductibility of employer contributions to you is determined solely with reference to sections 162, 419, and 419A of the Code. For this purpose, the exempt status (or lack thereof) of a trust to which such contributions are made is irrelevant. Under these Code sections, the employer's allowable deduction is generally limited to the plan's qualified cost. The qualified cost includes only the cost of pure insurance protection, as reduced by any earnings on the life insurance policies used, and not the premiums actually charged, which may include investment features. See Robert D. Booth and Janice Booth, et al v. Commissioner, 108 T.C. 524 (1997).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
TE/GE (T:EO:RA:T:4)
[REDACTED]
1111 Constitution Ave. N.W.
Washington, D.C. 20224

In lieu of sending any correspondence to the above address, you may FAX a response to us using the following number: 202-283-8937.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

cc: [REDACTED]